DUFF & PHELPS

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MARKET REPORT

European Mid-Market Debt Update

Record Levels of Deal-Making Despite Ongoing Pandemic

H1 2021

European Mid-Market Debt Update

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Executive Summary

The debt market recovery that started post-summer 2020 (and reflected mostly in Q4 data) has kept strong momentum into H1 2021, leading to record-breaking mid-market deal levels. High levels of equity and debt dry powder drove this trend, alongside pent-up buy and sell-side demand for M&A deals and regained investor confidence on the back of the COVID-19 vaccine rollout. Results from our survey showed that 73% of mid-market leveraged loan deals in H1 2021 were M&A driven.

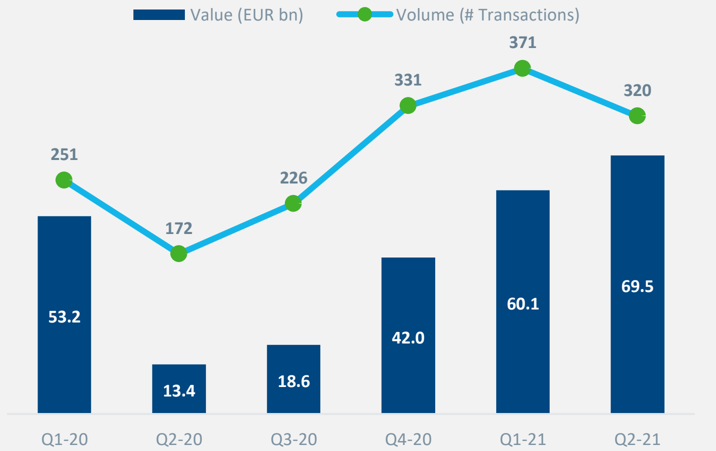
Leveraged loan lending continued to focus on businesses/sectors with low earnings volatility and recurring revenues, but data suggests that appetite for more cyclical sectors has improved compared to H2 2020. Geographically, the UK saw the most activity, representing 44% of deals (by count), followed at some distance by France and Germany.

In this report we present the usual lender 'league tables' for European direct lenders and UK bank and asset-based lending (ABL) providers. UK banks recovered some of the market share previously lost to direct lenders, however, the general increase in deal numbers does not highlight the continued decline of European clearing bank appetite for super senior revolving credit facilities (SSRCF). The UK ABL market also saw a very strong uptick in deal volume and less reliance on existing clients, but with most activity in the lower mid-market.

Whilst deal volumes seemed to ease off a little over the summer and lenders sought to take some much-needed annual leave, we expect strong deal momentum to continue in H2 2021. The unprecedented levels of government loans and other forms of support, combined with incumbent lender support, led to record-low levels of insolvencies in H1 2021. However, as most schemes are now unwinding, we do expect an increase in restructuring and (dis)stressed refinancing activity in the medium term. Whilst it is clear that environmental, social and corporate governance (ESG) is a theme of growing importance, we have not yet seen it actively factored into final loan documentation through well-defined margin ratchets.

Leveraged Loans – Western European M&A and Debt Deal Count

Western European M&A Value and Volume (1)



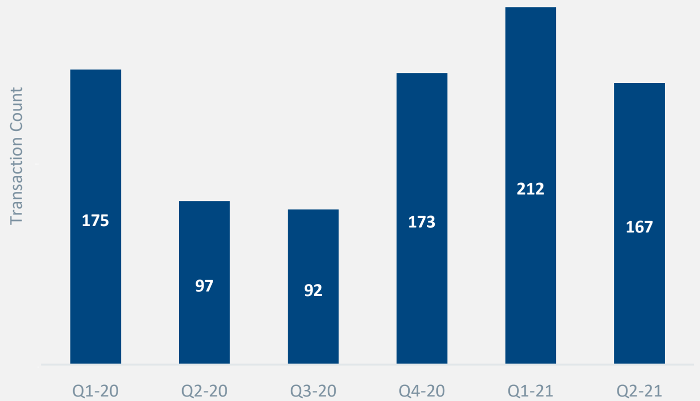
Source: Acuris Western Europe 1H21 Review – Buyouts Market Overview & Financing Trends

Strong M&A Momentum Continues into H1 2021

Western European M&A activity continued its momentum to reach a new high in H1 2021. Key driving factors were:

- Strong macroeconomic tailwinds from fiscal and monetary policy stimulus
- Faster-than-expected recovery from the pandemic resulting in an upward revision of growth expectations
- Continued lofty equity market valuations enticing owners to bring businesses to market
- A combination of pent-up demand for M&A (from both corporates and private equity), and the increased confidence in being able to finance them on attractive terms due to high levels of dry powder and buoyant debt market conditions

Western European Mid-Market Debt Transaction Count



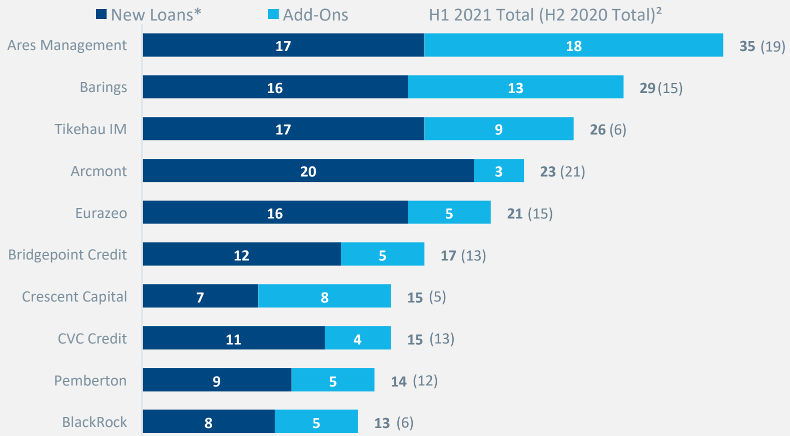
Source: D&P 2020 H2 Debt Mid-Market Survey

Record Levels of Debt Capital Deployment in Q2 2021

- Q1 2021 saw a record period for debt transaction count (212) when compared to recorded data from previous periods, before easing slightly in Q2 2021 (167) – in line with broader M&A activity
- Geographically, 44% of deals were completed in the UK, followed by 17% in France, 11% in Germany, 8% in the Netherland, 5% in Sweden and 15% in other countries
- Lenders also became more selective due to high levels of deployment and busy deal flow. Some lenders declined to participate in competitive sell-side processes, choosing to focus on deals only when they had a competitive edge. We also saw that a major fund paused lending in the UK due to heavy deployment and concentration issues

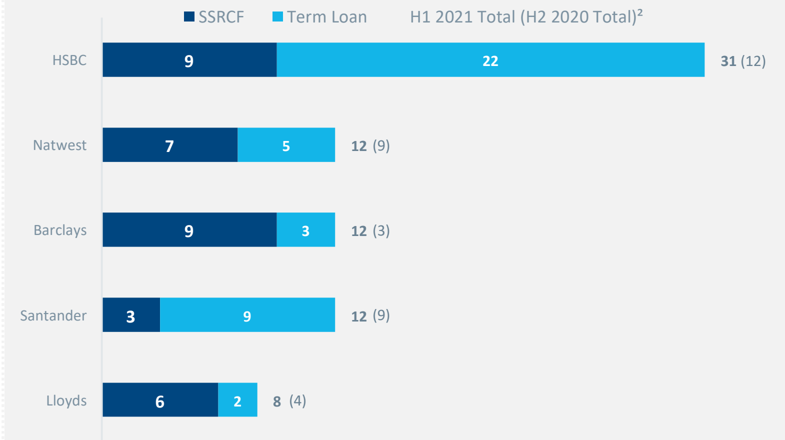
Leveraged Loans – Lender League Tables

Top 10 Funds Europe – H1 2021



Source: D&P 2021 H1 Debt Mid-Market Survey

Top 5 Banks UK – H1 2021



Source: D&P 2021 H1 Debt Mid-Market Survey

Familiar Lender Names Led the Way

Some European direct lenders almost doubled their deal count compared to H2 2020 and Crescent tripled deals written. Overall, Ares led the way with 35 deals (up from 19 in H2 2020), with the majority of their transactions UK-focused add-ons for existing portfolio companies across all size ranges. Barings completed 29 new money deals (up from 15), and focused predominately on Western European buyouts and add-ons between EUR 50-150 mn. Tikehau IM recorded 25 deals (up from 16), with half of their transactions in France and the majority of their transactions split between buyout and add-on transactions.

A full list of survey participants and their deal counts can be found in the appendix.

Banks Focus on Term Debt

Consistent with the major increase in deal count and slight recapture of market share by banks, the top five banks in the UK saw a strong growth in deal volume across term debt and SSRCFs.

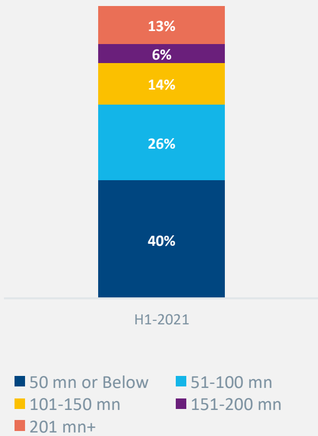
Obtaining SSRCFs from clearing banks continued to be challenging, as banks increasingly struggled to make them work from a *return on risk* perspective and/or the impact of the European Central Bank (ECB) imposed total gross leverage caps. This led to several fund-underwritten bridge facilities and created some opportunities for ABL lenders and specialist banks to step into this gap.

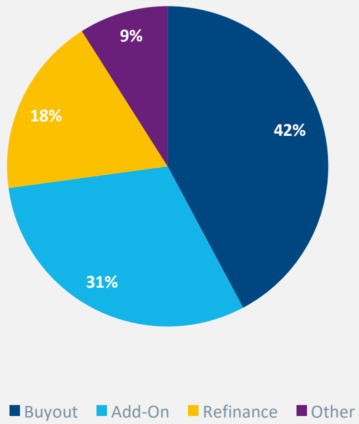
We saw a higher number of *first-out last-out* (FOLO) structures (13) compared to the previous period (3), but note that some lenders did not favour them.

[1] Our survey focuses on completed mid-market leveraged loans with total debt of between EUR 20 mn and EUR 300 mn
[2] H2-2020 total deal count. Where N.A is stated, the lender either did not participate in our previous survey or no deals were recorded for the period

Leveraged Loans – Transaction Purpose, Size and Sector

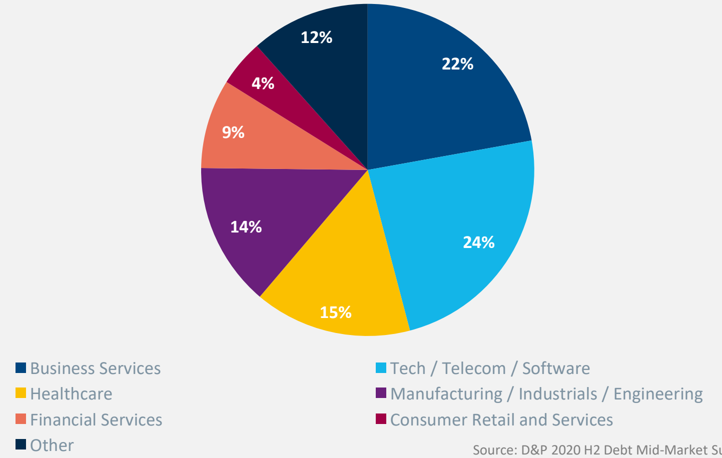
H1 2021 Transaction Size and Purpose (EUR mn)





Source: D&P 2020 H2 Debt Mid-Market Survey

H1 2021 Transactions by Sector (By Deal Count)



Source: D&P 2020 H2 Debt Mid-Market Survey

M&A Activity Drives Debt Capital Deployment

- M&A activity drove transaction purpose, representing 73% of transactions. New buyouts accounted for 42% (45% in H2 2020) of transactions and add-ons represented a further 31% (25% in H2 2020). Refinancing increased from 15% in H2 2020 to 18%. Dividend recaps and growth finance stayed stable in absolute terms, however reduced as a percentage of transaction during H1 2020 compared the prior period
- Transaction size reduced on average compared to H2 2020, with the largest change seen in the reduction of the EUR 201 mn+ size range down to 13% (from 17%)
- Debt transactions below EUR 50 mn (at 40%) were relatively flat on H2 2020

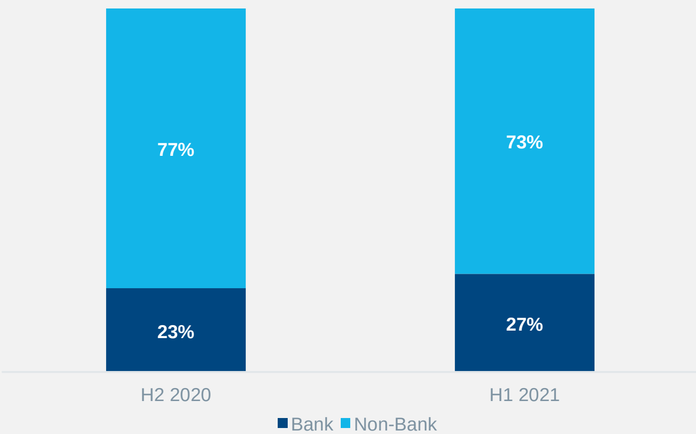
More of a 'Risk-on Tone' with Regards to Sector Split

- Business Services and Tech/Software continued to be the most popular sectors, as lenders continued to prefer businesses with low earnings volatility and recurring revenues
- However, the data suggest that there was increased appetite for cyclical sectors impacted by COVID-19, when compared to H2 2020. Deal count in Manufacturing, Industrials & Engineering was up from 8% to 14%; however Consumer Retail and Services was still flat on the last period
- The increase in Manufacturing M&A and Debt activity is consistent with the *Euro Area Manufacturing PMI Survey*, which recorded 4 successive record months between March and June 2021

Source:
1. Private Debt Investor, Fundraising Report 2020

Leveraged Loans – Fund vs. Bank Share and ESG Trends

Bank vs. Fund Market Share



Source: D&P 2020 H2 Debt Mid-Market Survey

Debt Fund Dominance Continues but Banks Win Back Some Market Share

- Banks increased their share of term debt facilities from 23% (H2 2020) to 27%
- In our opinion, contributing factors include:
  - Increased proportion of good quality deals, resulting in banks having the conviction to be more competitive
  - Banks feeling more confident that they have worked through COVID-19-related issues and more willing to deploy capital for the right deals and existing clients
  - Non-Bank lenders being more selective about deals due to the volume of opportunities currently available to them, leaving a void that banks can fill

Growing Importance of ESG Considerations

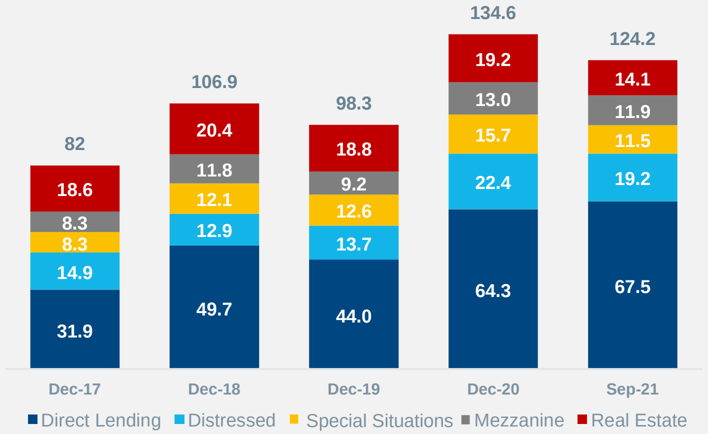
Fund Investors Drive Growth in ESG Considerations and Ratchets

- The ask for an ESG-linked interest margin ratchet is becoming more prevalent amongst direct lenders, and we are aware of at least one fund that will insist on ESG ratchets in all their deals
- Implementation is the current challenge. Commonly, the term sheet stage includes the concept of ESG ratchets; however, key performance indicators (KPIs) to drive the ratchet aren't agreed on and often don't make it into the final documentation. Also, where KPIs can be agreed on, they are often poorly defined and the ratchet is only for c. 15 basis points (bps)
- We do expect the market to become more focused on better defined KPIs as industry norms are established and more meaningful ratchet amounts are included. We also note the emergence of green bonds in some countries

Source:
1. Private Debt Investor, Fundraising Report 2020

Leveraged Loans – Debt Fund Dry Powder & Fundraising

Debt Fund Dry Powder (USD bn)

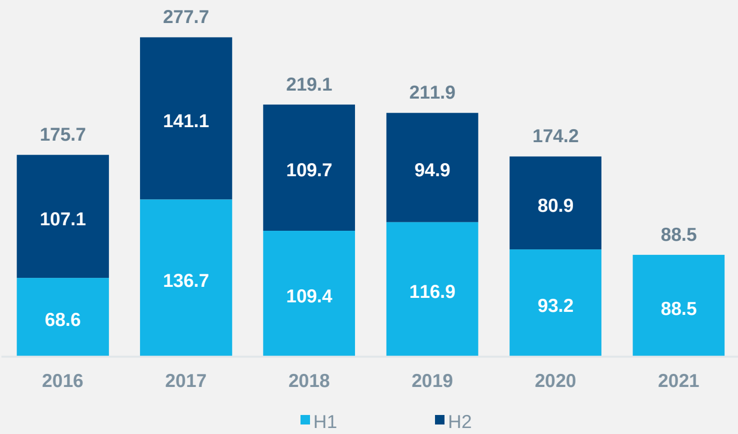


Source: Private Debt Investor, Fundraising Report H1 2021

Lower Level of Dry Powder, but Still Near Record Highs

- High levels of deployment and lower levels of fundraising (see below) have caused dry powder levels to come down from their record highs at December 2020
- Interestingly, the only category to show an increase in dry powder levels was Direct Lending
- This indicates strong investor appetite for Direct Lending (see also the next section) as an asset class, and a possible shift in focus to less risky lending strategies (excluding Real Estate). Distressed and Special Situations investors saw less deal opportunities due to high levels of government support (both through loan schemes and other measures) and borrowers benefitting from supportive incumbent lenders

Fundraising (USD bn)



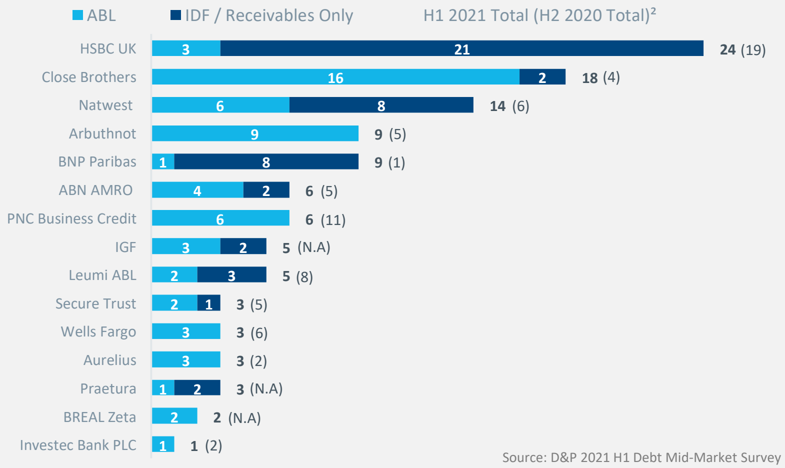
Source: Private Debt Investor, Fundraising Report H1 2021

H1 Fundraising Lower YoY, Direct Lending the Main Focus

- H1 2021 fundraising was lower than in H1 2020. The pandemic had a considerable impact on fundraisings as General Partners (GPs) were less able to meet potential investors. As a result, Limited Partners (LPs) typically chose to invest in managers they knew rather than embarking on new relationships
- The increased uncertainty created by the pandemic led investors to seek safer options, resulting in senior debt becoming the largest fundraising strategy
- Recent senior debt fund closures include Ares (EUR 9.5 bn), Park Square (EUR 1.8 bn), Kartesia and Sixth Street (both EUR 1.0 bn)
- Furthermore, there are still a large number of funds in market, targeting c. USD 97 bn of capital, indicating that the private debt asset class is well-positioned to recover following the pandemic

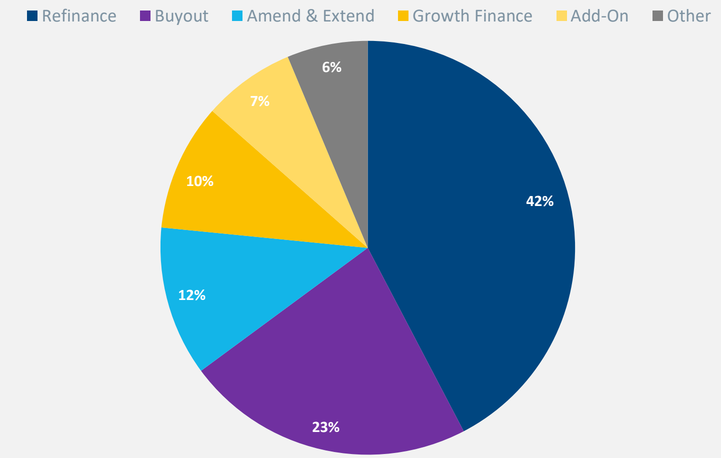
UK ABL Market: Deal Count by Lender and Loan Purpose

H1 2021 ABL Deal Count[1] by Lender



Source: D&P 2021 H1 Debt Mid-Market Survey

H1 2021 ABL Deals by Loan Purpose



Source: D&P 2021 H1 Debt Mid-Market Survey

Significant Uptick in ABL Deal Activity

15 participants reported a total of 111 asset-based transactions, a 42.3% increase on the 78 recorded in H2 2020 (which was relatively flat on H1 2020).

In the Invoice Discount Financing (IDF)/receivables-only segment, HSBC UK (21) was again the most active, followed by NatWest (8) and BNP Paribas (8).

In the multi-asset class segment, Close Brothers increased deal flow sharply from 4 in H2 2020 to 18, followed by Arbuthnot, up from 5 to 9. We do note that many of the deals reported by Close and Arbuthnot were lower mid-market deals (see also next page), which affects the rankings.

Shift From Refinancing/Extensions to New Client Deals

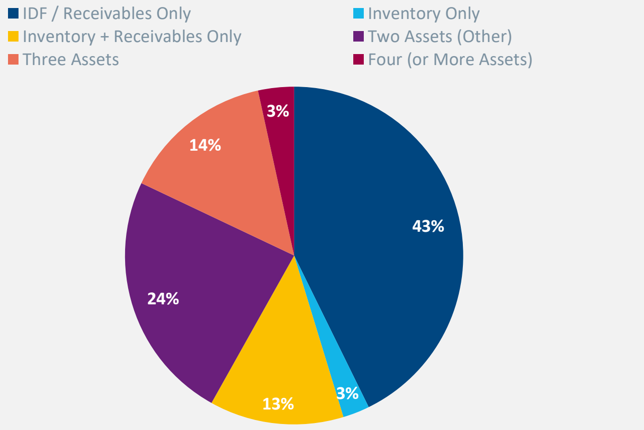
Whereas H2 2020 was a disappointing period for new client deals and emphasis was on portfolio ‘assistance’ deals, H1 2021 saw a healthy improvement, with 23% of deals for buyouts (up from 9%) and only 42% for refinancing and extensions (down from 71%).

Many lenders saw their drawn loan book shrink in 2020, on the back of lower levels of new deals and heavily reduced utlisation levels (some reporting a reduction of 30-40%). The uptick in new money deals has helped grow total loan commitments, but some reported a lag in recovery of the drawn loan book as Brexit and the pandemic led to some corporates overstocking in 2020. The introduction of Crown Preference may also have been a factor.

[1] Our survey focuses on IDF/receivables-only facilities and multi-asset class ABL financings with total debt of between GBP 5 mn completed and GBP 250 mn
[2] H2-2020 total deal count. Where N.A is stated, the lender either didn’t participate in our previous survey or no deals were recorded. For the period

UK ABL Market: Asset Classes and Transaction Size

Asset Class Breakdown



Source: D&P 2021 H1 Debt Mid-Market Survey

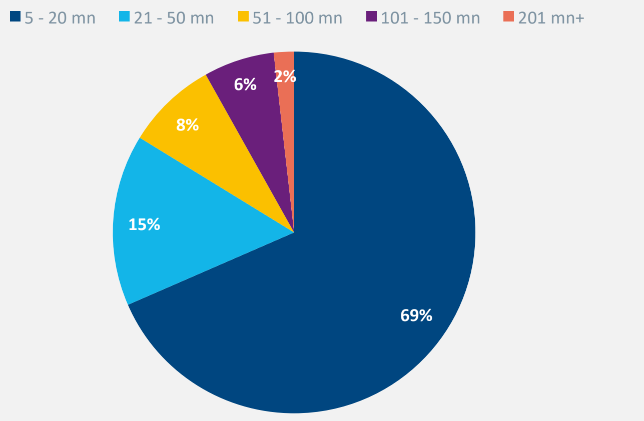
Small Decline in Share of Multi-Asset Class Lending vs. IDF

IDF/receivables-only deals represented 43% of deal count, an increase from 38% recorded in H2 2020 and 54% covered multi-asset class (down from 59%). This seems to bring us more towards pre-pandemic relative levels between the two segments.

Reduced use of inventory lending on the back of the introduction of Crown Preference in late 2020 and a strong step back in the levels of Coronavirus Large Business Interruption Loan Scheme/Coronavirus Business Interruption Loan Scheme (CLBILS/CBILS) lending seen in 2020, may have been contributing factors.

In the ABL segment, few transactions were backed by three or more asset classes (17%), down from 26% in the last period.

Transaction Size (GBP)



Source: D&P 2021 H1 Debt Mid-Market Survey

Emphasis on Sub-GBP 20 mn Deals

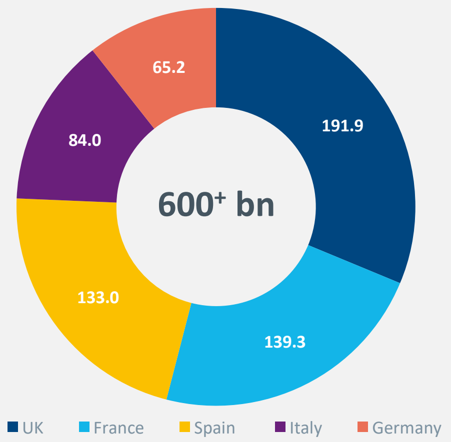
Deal activity focused on smaller transactions, with 69% of deals recorded below GBP 20 mn vs. 51% in H2 2020. Deals below GBP 50 mn at 84% were not far from levels seen in H2 2020 (88%).

A notable larger ABL transaction was the Clayton Dubilier & Rice-led Wolseley transaction financed by a unitranche facility (Atlantic Park) and a sizable ABL facility (underwritten and then upsized and syndicated by BNP).

We hope to see more of these much talked about ABL plus unitranche deals going forward, given reduced clearing bank appetite for SSRCFs, but note that these will only be relevant in sectors with a large working capital requirement.

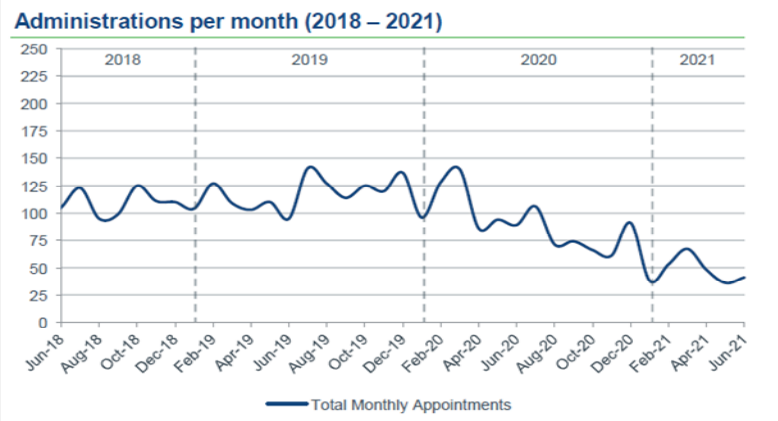
COVID-19 Government Support & Impact on Restructurings

European Government Loan Schemes (EUR bn)[1]



Source: See footnote

UK Administration Statistics



Source: Kroll Administration Statistics, June 2021

European Government Loan & Other Support

- Overall, the various European government schemes have been successful in assisting companies to weather the COVID-19 pandemic, with impressive levels of capital deployed (see above), often combined with other support measures such as furlough schemes, resulting in reduced number of insolvencies (see right)
- In the UK, businesses will soon need to commence repayment of CBILS/CLBILS and Bounce Back Loans (BBL) alongside the agreed HM Revenue & Customs and Time To Pay and other rental arrangements. In the near term, we expect private markets to be asked to refinance these loans and we are waiting to see how much appetite there will be
- There are also concerns around the potential impact of fraud, particularly in the UK around the BBL scheme

Insolvency Levels & Government Support

- Administration levels in the UK for H1 2021 are down 55% compared to H2 2020 and remain significantly below historical levels. This trend is consistent across all types of insolvency and generally seen across Europe, given the unprecedented government initiatives designed to stabilise businesses over the past 18 months
- Statutory demands and winding-up petitions only relating to built-up debts will also remain restricted until the end of September 21 (or March 22 in the event of lease forfeiture)
- Across Europe, state-backed job retention schemes are set to end, or become less generous, including the UK at the end of September

1. Graph Source:
Bank of England as of 8 September 2021, HM Treasury as of 8 July 2021, Bundesministerium für Wirtschaft und Energie of 9 September 2021, Ministere De L'Economie Des Finances et De La Relance as of 13 Sept 2021, Ministero dello sviluppo economico as of 30 June 2021, Sace Simest Gruppo cdp as of 8 September 2021

Market Outlook

Strong Deal Flow is Expected to Continue

- We expect the current M&A boom to continue, driven by strong macro-factors and continued confidence from both investors and lenders
- PE and Direct Lending have high levels of dry powder and are expected to receive strong fundraising appetite from LPs, allowing for continued strong capital deployment

Increase Lender Action / Restructurings

- Government loan schemes have resulted in increased liabilities on corporate balance sheets which will require servicing. Any applicable (re-) payment breaks will come to an end
- Other types of government support are also unwinding and, as moratoriums on lender action are removed, we expect increased lender action and restructurings

Lenders Becoming More Selective

- We expect lenders to be selective regarding lending opportunities shown to them as they factor in relative credit quality and opportunity costs in the context of resource constraints
- This could result in a short-term bifurcation of lender appetite and opportunities for ABLs and more expensive pools of fund capital to be deployed

ESG Growing in Importance

- ESG margin ratchets are much talked about but often not written into loan documents in detail yet. However, given the focus on ESG by investors, we expect that this will change soon
- Sectors not considered ESG-friendly are going to be under increasing pressure to improve this or they will find obtaining capital more difficult or more expensive

Duff & Phelps Debt Advisory Contacts

Jacco Brouwer
Head of European Debt Advisory
London
+44 (0)7 467 004 706
Jacco.Brouwer@duffandphelps.com

Greg Forde
Director, European Debt Advisory
London
+44 (0)7 557 758 356
Gregory.Forde@duffandphelps.com

Darren Coyne
Associate, European Debt Advisory
London
+44 (0)7 824 550 302
Darren.Coyne@duffandphelps.com

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Appendix – Further Survey Results and Data

European Direct Lender Deal Count H1 2021[1]

Lender	Deal Count
Ares Management	35
Barings	29
Tikehau IM	26
Arcmont	23
Eurazeo	21
Bridgepoint Credit	17
CVC Credit	15
Crescent Capital	15
Pemberton	14
BlackRock	13
Alcentra	12
Permira	11
Ture Capital	10
Muzinich	10
CORDET Private Debt	9
Kartesia	8
Capital Four	7
Bain Capital	7
Ardian	6
HIG Whitehorse	5
Northleaf	5
LGT Capital	4
Pricoa Private Capital	4
Apera	4
Proventus	4
Five Arrows	3
Hayfin	2
Guggenheim	1
Total	**321**

1. Some direct lenders also provided RCF facilities. In addition to the above deal count, CORDET and Pricoa provided 1 and 2 RCF facilities, respectively

UK ABL Deal Count H1 2021[2]

Lender	Deal Count
HSBC UK	24
Close Brothers	18
Natwest	14
BNP Paribas	9
Arbuthnot	9
PNC Business Credit	6
ABN AMRO	6
Leumi ABL	5
IGF	5
Praetura	3
Aurelius	3
Wells Fargo	3
Secure Trust	3
BREAL Zeta	2
Investec Bank PLC	1
Total	**111**

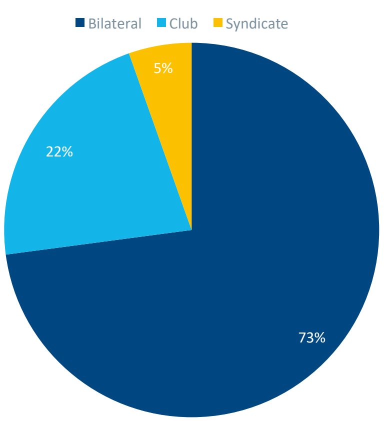
2. UK deal count only. Several lenders also lent across Europe during H1 2021 and these have not been included in this table

UK Bank Deal Count H1 2021[3]

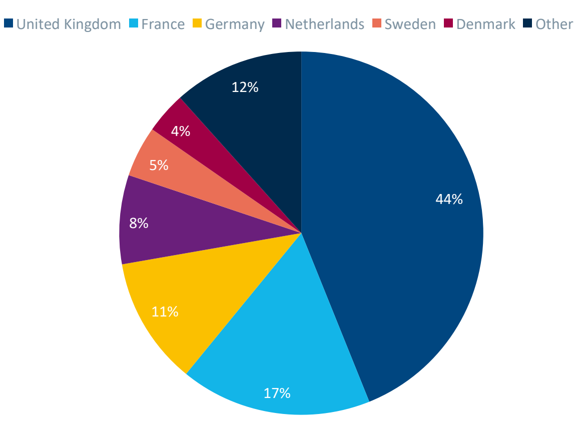
Lender	Term	SSRCF
HSBC	22	9
Santander	9	3
Barclays	3	9
Natwest	5	7
Lloyds	2	6
SMBC	5	0
CIC	3	0
NIBC	1	1
Deutsche Bank	2	0
Macquarie	1	0
Total	**53**	**35**

3. Some banks can provide unitranche loans. CIC, Deutsche, HSBC, Investec, Macquarie, Natwest, NIBC and SMBC have submitted additional deals completed in Europe of 1, 3, 1, 4, 4, 1, 9 and 6 respectively

Leveraged Loans by Arrangement



Leveraged Term Loans by Geography



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